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PUBLIC VERSION

Dear Susan

FONTERRA'S APPLICATION FOR AUTHORISATION: RESPONSE TO REQUEST FOR CLARIFICATION

1 I refer to your letter of 18 November 2011 seeking clarification with respect to the proposed intermodal services that Kotahi may offer and the contemplated exclusivity requirements for those services.

2 While we have endeavoured to provide as much detail as is currently available, it is important to note that Kotahi's initial focus will be on optimising outbound/inbound containerised ocean freight movements for its limited partners and other customers. It is anticipated that Kotahi's local land-based services and coastal shipping offering will develop over time as opportunities to generate cost savings or provide a better service offering are identified. Those opportunities will likely become more apparent as Kotahi becomes fully operational. As a result, it is difficult at this stage to be precise as to the nature of, and the form that, such future service offerings may take.

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5 In summary, the aspects for which authorisation is being sought are as follows:

5.1 On the international ocean freight side (and only to the extent that they are not covered by the section 44(2) exception – although, as mentioned in the application, we note the scope of this exception is unclear and its longevity may be in doubt) authorisation is sought for:

- (a) the exclusivity requirement set out in clauses 4.1 and 4.4(b) of the Limited Partnership Agreement and clause 12 of the draft Services Agreement;
 - (b) the pricing mechanism set out in clause 4.8 of the Limited Partnership Agreement (reflected in clause 17 and Schedule 2 of the draft Services Agreement); and
 - (c) the potential overall effect of the arrangements comprising the combined effect of clause 3 of the Establishment Agreement, clauses 2.7, 5 and schedule 2 of the Limited Partnership Agreement and clauses 43 and 44 of the General Partner Constitution.
- 5.2 On the local land-based services and coastal shipping side, authorisation is sought for those provisions of the Limited Partnership Agreement and General Partner Constitution that, combined, are likely to breach section 30 of the Commerce Act in that they are likely to have the effect of the parties fixing, controlling or maintaining price (see discussion below) namely:
- (a) clauses 2.7, 5 and Schedule 2 of the Limited Partnership Agreement; and
 - (b) clauses 43 and 44 of the General Partner Constitution.
- 6 It is important to note that Kotahi Logistics' potential local land-based services and coastal shipping offerings are not intended necessarily to comprise the whole of a limited partner's or customer's local transport requirements. That is, no exclusivity requirement is intended in relation to such services. Rather, Kotahi will develop and offer intermodal transport solutions comprising road, rail and coastal shipping (in a variety of combinations) on particular routes, or for specific customers, where there is an opportunity to create cost savings for those affected.
- 7 Having developed the particular intermodal transport offering, Kotahi then will contract with the relevant limited partners and/or customers who wish to utilise that service. These customers will be free to choose Kotahi's offering or any alternative transport solution for which they can contract independently of Kotahi (e.g. by continuing their existing transport arrangements).
- 8 Further, while limited partners and customers may procure a particular intermodal service from Kotahi, these parties' other land-based services and coastal shipping requirements will be dealt with separately (either by Kotahi or otherwise).
- 9 It is Kotahi's ability to combine various cargo demand profiles from both its limited partners and other customers that will allow it to develop and procure intermodal transport solutions that individual freight owners on their own do not have the ability to secure.
- 10 Importantly, the potential overall effect of these intermodal transport solutions is unlikely to raise Commerce Act concerns to the extent that there is any actual substantial lessening of competition in affected market. Rather, it is the

arrangements establishing the jointly owned Kotahi entity that require authorisation (for the reasons and to the extent described in paragraph 5 above).

Scope of the current services agreement

- 11 The draft Services Agreement, provided in Schedule 5 of the application, is focused on the provision of containerised ocean freight and those directly related landside services that effectively comprise part of the ocean freight service offering (i.e., collection from the nominated place of acceptance by the ocean freight carrier).
- 12 This form of contract is not dissimilar from what an individual freight owner might expect to enter into directly with an ocean freight carrier [

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- 13 Under these “direct” agreements, the customer is responsible for delivering the packed container to the nominated place of acceptance (which may be at the port or inland railhead); and the carrier is responsible for loading the vessel, transporting the cargo to the port of destination and unloading it at that port – in this regard, the carrier contracts with the relevant ports and other port based service providers to undertake these activities.
- 14 The key differentiating factor between the basic “direct” relationship contract and the draft Services Agreement is that under the draft Services Agreement Kotahi is providing a procurement service in terms of which it undertakes to procure the provision of ocean freight carriage from the nominated places of acceptance for the contracted party (i.e. Fonterra or Silver Fern Farms).
- 15 In providing that procurement service, Kotahi is free to select the particular carrier or service, which allows Kotahi to optimise the cargo requirements of multiple parties.
- 16 As result of Kotahi’s initial focus and as a function of the contracting model described above, the draft Services Agreement does not presently deal with intermodal services that may be provided by Kotahi and addresses only a limited range of landside services to the extent that these are provided by the carriers (or their sub-contractors) in transporting packed containers from the place of acceptance and loading these onto the vessel for shipping.
- 17 It is possible that the scope of the draft Services Agreement in its present form may be amended to reflect additional landside and intermodal transport services to be provided by Kotahi. However, given that a number of the provisions of the draft Services are specific to the procurement of ocean freight carrier services, it may be more likely that the draft Services Agreement will be supplemented with separate agreements relating specifically to the provision of these additional services.
- 18 In that event, we note that these separate intermodal service agreements would be in substantially the same form as the draft Services Agreement – albeit with some minor modifications to reflect the specialised nature of the particular intermodal service it involved.

Consideration of intermodal services – potential difficulties

- 19 Whilst the provisions of the draft Services Agreement do not currently deal with the provision of intermodal services by Kotahi and the detail of these provisions (and the identity of potential parties) remains unknown, there are some aspects of the proposed arrangements relating to the potential provision of intermodal transport services that require authorisation at present.
- 20 Schedule 2 of the Limited Partnership Agreement (provided in Schedule 4 of the application) clearly contemplates that the business of Kotahi will include the provision of “intermodal (land and ocean) based transport solutions for importers, exporters and carriers”.
- 21 As both Fonterra and Silver Ferns Farms (and any other future partners in Kotahi Logistics) are competitors for the acquisition of such services, the ability of Kotahi to go out and negotiate such arrangements – particularly where such arrangements constitute Limited Partner Reserved Matters requiring approval of the limited partners pursuant to clause 5.1(b), raises the potential application of section 30 of the Commerce Act (even before the exact substance of these arrangements is known).
- 22 Section 58(1) of the Commerce Act provides that the Commission may grant an authorisation for a person to enter into of a contract or arrangement or arrive at an understanding to which that person considers section 27 of the Commerce Act will apply (section 58(5) contains a similar provision in respect of section 29).
- 23 By entering into the Limited Partnership Agreement, Silver Fern Farms and Fonterra (and other potential limited partners) will be entering into a contract that contains provisions that are likely to have the effect of fixing, controlling or maintaining the price of goods or services acquired by them in that these provisions establish Kotahi to perform “intermodal (land and ocean) based transport solutions” for the limited partners and provide those limited partners with the mechanism by which they can control the price at which they acquire those services (via clause 5 of the Limited Partnership Agreement and clauses 43 and 44 of the General Partner Constitution) – resulting in a likely breach of section 27 via the deeming provision in section 30. The profit sharing mechanism set out in clauses 6 and 7 of the Limited Partnership Agreement may also be relevant here in that it could impact on the price of the services.
- 24 It is these aspects of the proposed arrangement, rather than any specific provision of the draft Services Agreement, for which authorisation is sought.
- 25 However, an arms length services agreement between Kotahi and an independent customer (in particular) under which Kotahi offers an intermodal transport solution, is unlikely to result in a breach of the Commerce Act – unless it contains an exclusivity requirement (see discussion below).
- 26 With this in mind, we see the resulting services agreements (be they for ocean freight procurement or intermodal land transport solutions) as simply the outcome of the combined negotiation/procurement process contemplated by the Limited

Partnership Agreement rather than containing any specific provisions that breach the Commerce Act in themselves.

Exclusivity

- 27 It is not intended that limited partners (or other customers) will be required to procure the whole of their landside and coastal shipping services requirements from Kotahi Logistics.
- 28 That said, certain providers may require volume commitments where these are necessary to underwrite the provision of a particular service. In such a case, any volume commitment provision would still remain to be tested under the Commerce Act and, if in breach, an authorisation could be sought – as has been done in relation to the exclusivity provision in respect of ocean freight procurement services.
- 29 We note that the type of volume commitments contemplated by Kotahi are common in contracts where the customer is purchasing services directly from the relevant transport provider as these reduce the risk faced by the transport provider in incurring the costs associated with providing the particular service. [

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- 30 Where Kotahi does offer intermodal transport services to limited partners and customers, it will effectively be competing with the existing service providers and will need to provide a service that offers a cost saving or other efficiency benefit that cannot be obtained by the relevant limited partner or customer simply contracting with the service providers directly (as, in such a case, the customer would recognise that by contracting with the service provider directly it can retain Kotahi Logistics' profit margin for itself).

Yours sincerely

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